

**STATE OF CALIFORNIA
DEPARTMENT OF INSURANCE
45 Fremont Street, 24th Floor
San Francisco, California 94105**

INITIAL STATEMENT OF REASONS

Removal of Restrictions on Mortality Adjustment Factors

Date: September 20, 2010

Regulation File: REG-2010-00007

INTRODUCTION

The Insurance Commissioner proposes to amend California Code of Regulations (“CCR”) Title 10, Chapter 5, Subchapter 3, Article 12.3 (“Valuation of Life Insurance Policies”) Section 2542.4, titled “General Calculation Requirements for Basic Reserves and Premium Deficiency Reserves” as described below.

The Insurance Commissioner proposes to adopt the amendments to Section 2542.4 pursuant to the rulemaking authority vested in him by Insurance Code Section 10489.94 of the Standard Valuation Law. The Commissioner’s decision on the proposed amendments to Section 2542.4 will implement, interpret, and make specific the provisions of Insurance Code Section 10489.94 which state that it is the intent of the Legislature that the regulations authorized by Section 10489.94 contain the provisions of the National Association of Insurance Commissioners (“NAIC”) Model Regulation No. 830. The proposed amendments to Section 2542.4 are necessary in order to carry out the purpose of Insurance Code Section 10489.94.

SPECIFIC PURPOSE AND REASONABLE NECESSITY FOR AMENDMENTS TO REGULATION

The specific purpose of each amendment and the rationale for the Commissioner’s determination that each amendment is reasonably necessary to carry out the purpose for which it is proposed is set forth below. The letter and number designations for some subsections of Section 2542.4, as well as references to some subsection numbers, have been changed to accommodate the changes made by adopting amendments from the NAIC Model

Section 2542.4 General Calculation Requirements for Basic Reserves and Premium Deficiency Reserves

Subsection (b)(3):

Existing Subsections (B) and (C) of Section 2542.4(b)(3) are restrictions on the X factor referenced in Section 2542.4. They provide that X shall not be less than 20%, and X shall not decrease in successive years. The proposed amendments delete Subsections (B) and (C). The purpose of these amendments is to conform the subsection to the NAIC Model and to allow insurers to adjust the valuation mortality used in the calculation of deficiency reserves to make

the reserves correspond more closely with the expected mortality for a particular book of business. In other words, the amendments allow insurers to reserve more precisely and accurately and to lower their deficiency reserves when warranted. The proposed amendments to Subsections (B) and (C) are reasonably necessary to achieve this objective.

Existing Subsections (D) through (I) of Section 2542.4(b)(3) have been re-lettered as Subsections (B) through (G) as a result of deleting existing Subsections (B) and (C).

The words “does not decrease in any successive policy years as long as it” have been deleted from existing Subsection (G) of Section 2542.4(b)(3). The purpose of this amendment is to conform the subsection to the NAIC Model and to remove a restriction on the X factor. This allows insurers to adjust the valuation mortality used in the calculation of deficiency reserves to make the reserves correspond more closely with the expected mortality for a particular book of business. In other words, the amendment allows insurers to reserve more precisely and accurately and to lower their deficiency reserves when warranted. The proposed amendment to existing Subsection (G) is reasonably necessary to achieve this purpose.

A new subparagraph 2 has been added to existing Subsection (I) and the existing subparagraph 2 has been renamed subparagraph 3. The new subparagraph 2 requires an appointed actuary to make a statement each year as to the adequacy of reserves to pay benefits and expenses. Section 5 of NAIC Model No. 830 has the same requirement. The purpose of this amendment is to conform Section 2542.4 to the NAIC Model and to ensure that reserves are not inadequate. The reference in existing Subsection (I) to “Items 1. and 2.” has been changed to refer to “Items 1., 2., and 3.” to accommodate inclusion of the amendment. These amendments are reasonably necessary to achieve these purposes.

SPECIFIC TECHNOLOGIES OR EQUIPMENT

Adoption of the amendments to the regulation would not mandate the use of specific technologies or equipment.

IDENTIFICATION OF STUDIES

There are no technical, theoretical, and empirical studies, or similar documents relied upon in proposing the adoption of the amendments to Section 2542.4. The Commissioner has relied upon the NAIC’s Model No. 830 as amended by the Joint Executive Committee/Plenary in September 2009 and the NAIC’s 9/23/09 Project History of the September 2009 revisions to Section 5 of the NAIC Model No. 830 in proposing adoption of the amendments to Section 2542.4. Copies of the NAIC Model Regulation No. 830, Section 5 of the NAIC Model No. 830 dated 9/23/09 showing the revisions made to Section 5, and the NAIC’s 9/23/09 Project History for the September 2009 revisions to Section 5 of the NAIC Model No. 830 are included in the rulemaking file.

REASONABLE ALTERNATIVES TO THE REGULATIONS; IMPACT ON SMALL BUSINESS

The Commissioner has identified no reasonable alternatives to the presently proposed amendments to the regulation, nor have any such alternatives otherwise been identified and brought to the attention of the Department of Insurance, that would carry out the purpose for which the amendments to the regulation are proposed or which would lessen any impact on small business. Indeed, the proposed amendments to the regulation are not anticipated to affect small business. Insurance companies are not small businesses. Government Code Section 11342.610(b)(2). Although performance standards were considered as an alternative, they were rejected as unreasonable and ineffective in addressing the problem of conforming Section 2542.4 to the 2009 revisions to NAIC Model No. 830 and establishing more uniform standards among various states and the NAIC.

ECONOMIC IMPACT ON BUSINESS AND THE ABILITY OF CALIFORNIA BUSINESSES TO COMPETE

The Commissioner has made an initial determination that the amendment of this regulation may have a significant, statewide adverse economic impact directly affecting business, including the ability of California businesses to compete with businesses in other states. The types of businesses that may be affected are insurance companies. Although the Commissioner expects that the amendments will reduce costs overall because the amendments remove restrictions on the use of mortality adjustment factors, thereby allowing insurers to lower their reserves, insurers may incur some administrative costs as a result of modifying the way they calculate reserves.

The Commissioner has considered performance standards, but the Commissioner has identified no performance standards which would be as effective as the proposed amendments to Section 2542.4 in removing the mortality adjustment factor restrictions from Section 2542.4.

The Commissioner has not considered other proposed alternatives that would lessen any adverse economic impact on business and invites you to submit proposals. Submissions may include the following considerations:

- (i) The establishment of differing compliance or reporting requirements or timetables that take into account the resources available to businesses;
- (ii) Consolidation or simplification of compliance and reporting requirements for businesses;
- (iii) The use of performance standards rather than prescriptive standards;
- (iv) Exemption or partial exemption from the regulatory requirements for businesses.

PRENOTICE DISCUSSIONS

The Commissioner has not conducted a prenotice public discussion of the proposed amendments to Section 2542.4 pursuant to Government Code Section 11346.45 because he has concluded that the proposed amendments do not “involve complex proposals or a large number of proposals which cannot be easily reviewed during the comment period.” Government Code Section 11346.45(a).

The proposed regulations are essentially the same as the revisions made to Section 5 of the NAIC Model No. 830 in September 2009. The only differences between the revisions and the proposed

amendments are non-substantive changes concerning subsection letters and numbers. The NAIC Model No. 830 is the product of NAIC-sponsored public committee meetings. Any interested party has had the opportunity to participate in the meetings and to comment on the changes to the NAIC Model at these meetings. The NAIC publicly finalized the revisions to Section 5 of the NAIC Model 830 in 2009. The insurance industry generally follows NAIC activities, and interested parties are most likely already aware of the revisions made to Section 5 of NAIC Model No. 830.

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